

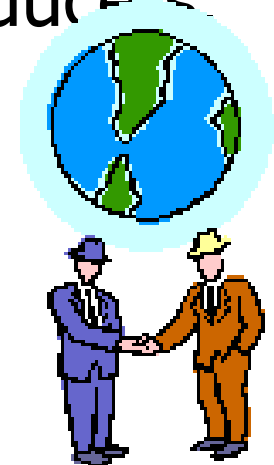
Protectionism *aka Trade Barriers* *3.1b*

Every year there is some version of this on
the test 😊



FREE TRADE or PROTECTIONISM?

- ⊕ Free trade = no trade barriers
 - ⊠ Trade is allowed to be conducted w/o any restrictions
 - ⊠ Absence of artificial barriers (government imposed)
- ⊕ Protectionism = imposing trade barriers to protect the income of domestic producers





Overview of Types of Protectionism

✚ Direct forms of Protectionism

- ✚ Embargo
- ✚ Tariffs
- ✚ Quota
- ✚ subsidies

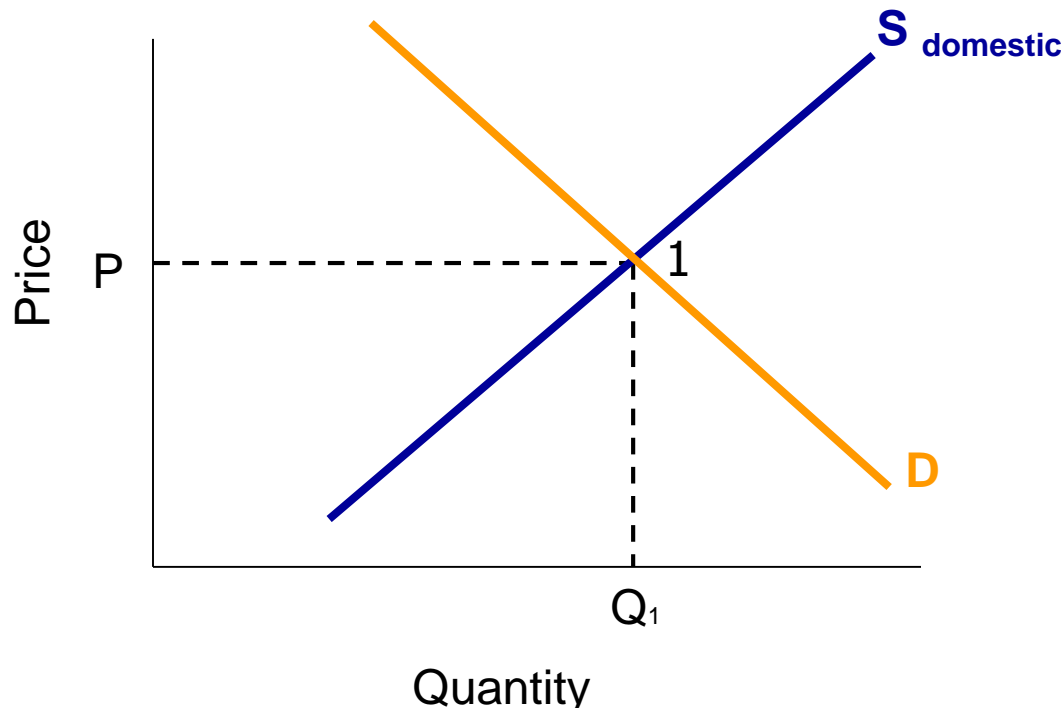
✚ Alternative forms of Protectionism

- ✚ VER
- ✚ Exchange Controls
- ✚ Import Licenses
- ✚ Administrative Barriers
 - Health and safety
 - environmental

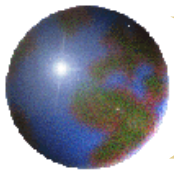


Embargo: Total ban or lack of on trade

- ✚ May be self-imposed by a domestic government
 - ✚ Self-imposed embargos on illegal drugs, endangered animals etc
- ✚ Imposed from outside for political or military reasons.
 - ✚ Most effective when country can't produce embargoed goods by themselves, or at a very high cost.

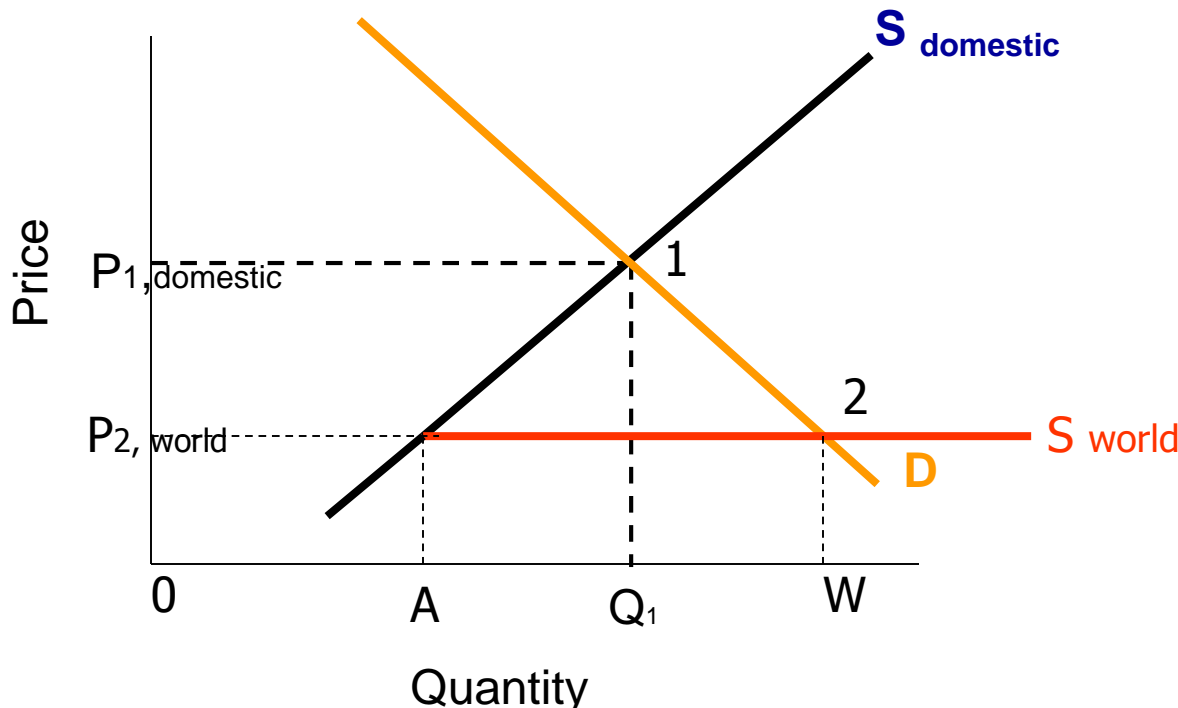


Pt. 1 is equilibrium
for domestically
produced goods.

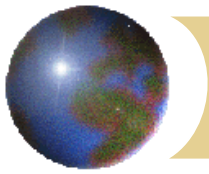


Complete Free Trade

- Due to comparative advantage, imports flow in at P_2 , as foreign merchants can undercut domestic production.



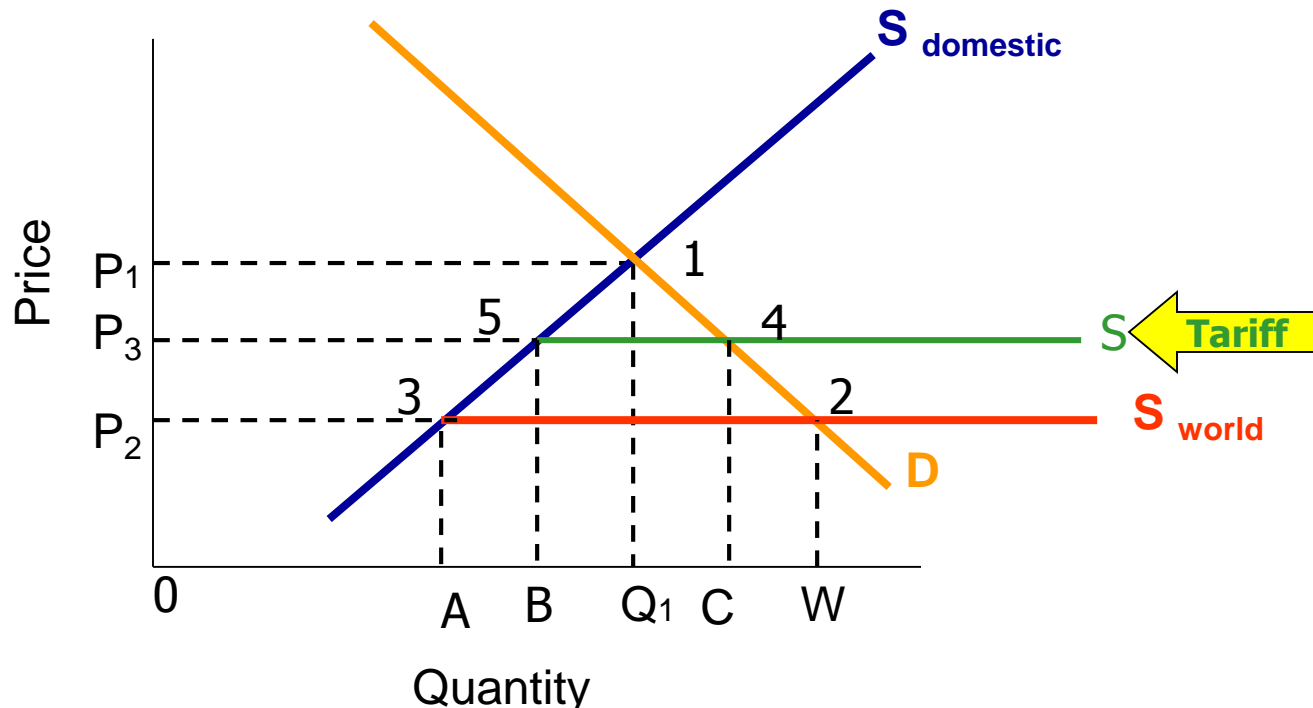
Pt. 2 trade benefits consumers because prices are lower (from p_1 to p_2) and they have more goods available, Q_0 to Q_w . Domestic producers lose because they sell less, A to Q_0 and at a lower price, p_2 instead of p_1 .

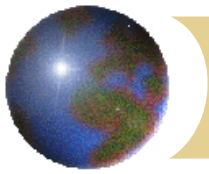


Tariff: tax on imports

✚ ad valorem

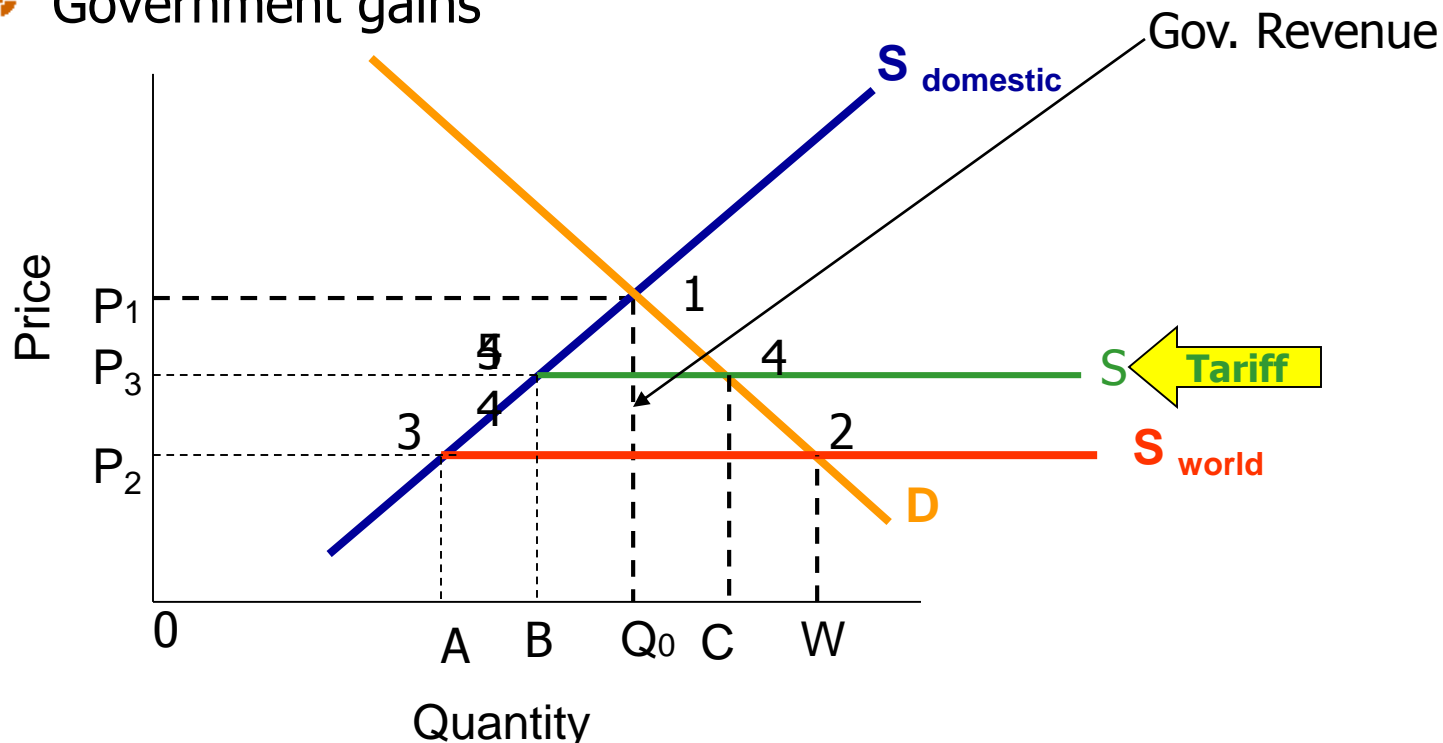
- ✚ A tax on a good whose amount depends on the value of the good or service, eg. 15% sales tax

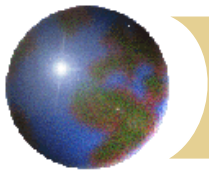




Tariff - Domestic Impact

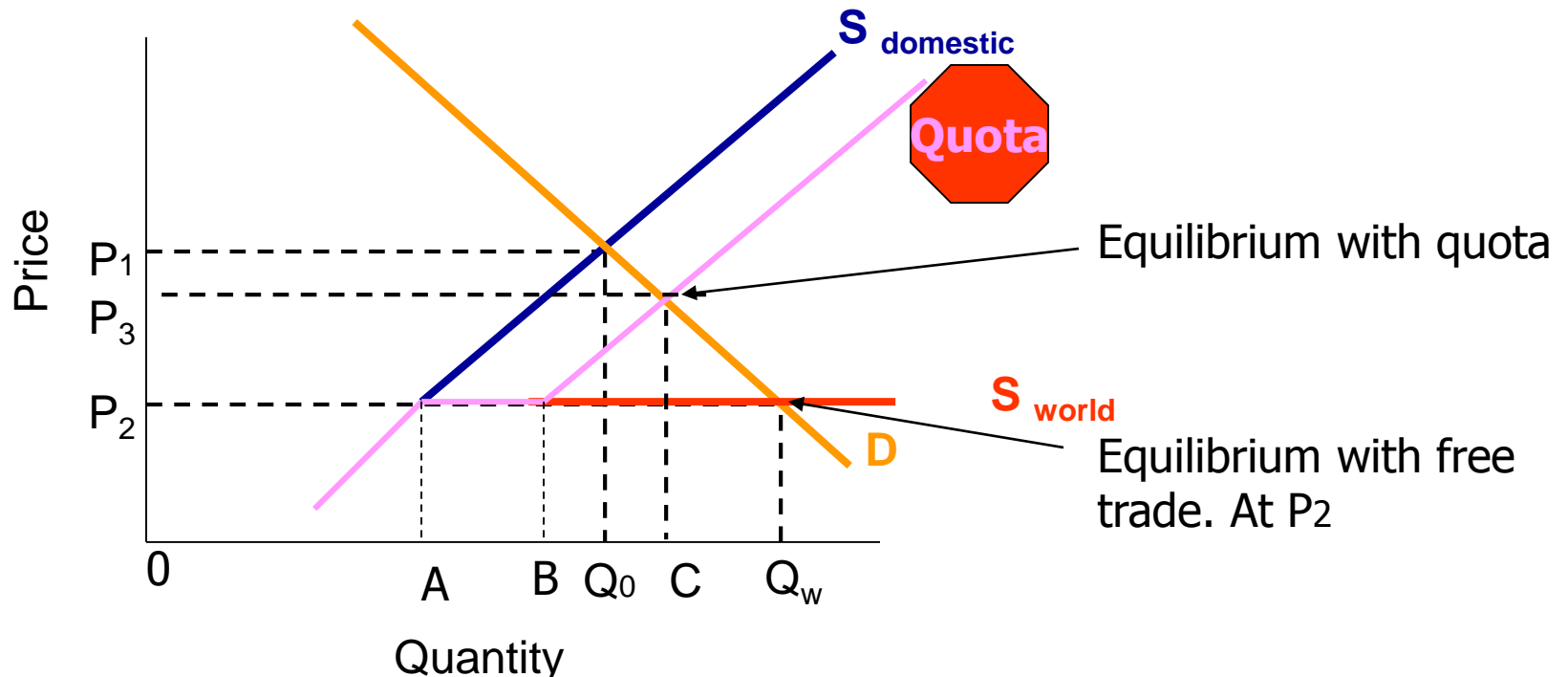
- Producers benefit- A to B and those producing at 0 to A get higher price (OP_3 rather than OP_2)
- Consumers lose- higher prices at P_3 and fewer goods at C rather than W.
- Government gains





Quotas-

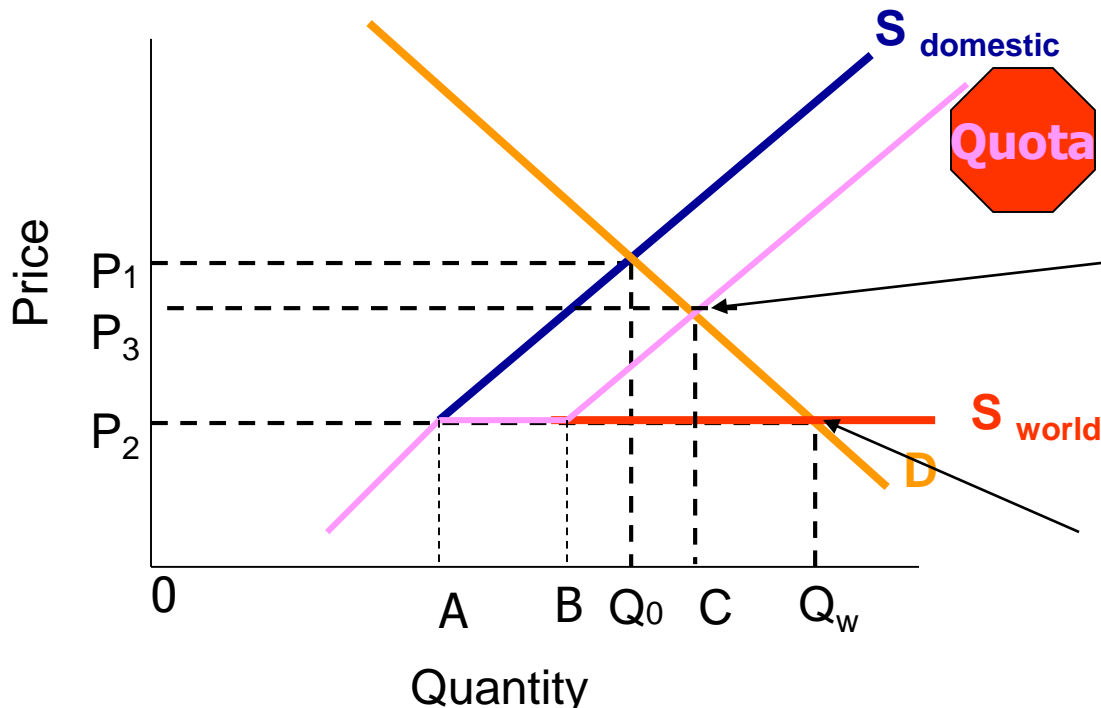
A physical limit on the amount of goods which may be imported in a set period of time





Quota- Domestic Impact

- ⊕ Producer Benefits – Better than free trade but not as good as an embargo
- ⊕ Consumer Result – Increased P but decrease Q compared to free trade but lower P and higher Q than without free trade.



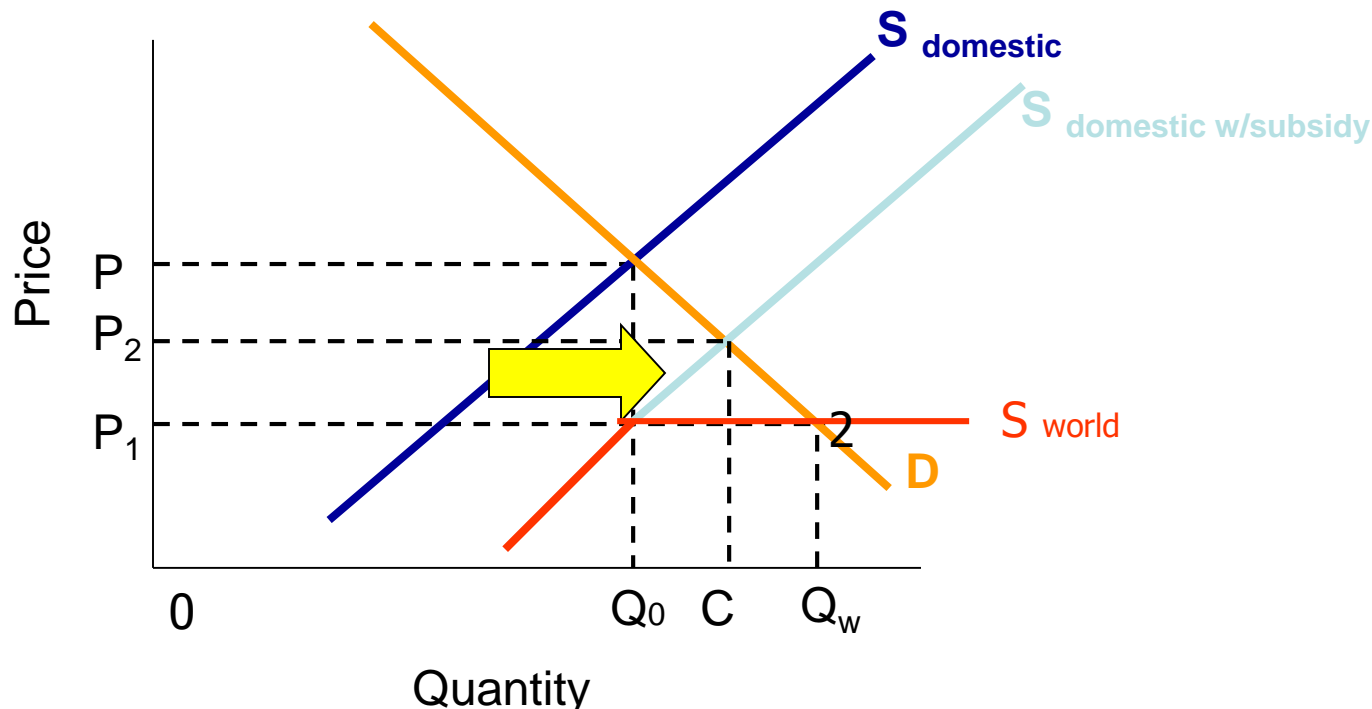
Equilibrium with quota at P_2 the free trade allows certain goods in up to the max of B and then no more M allowed so supply = S_d

Equilibrium with free trade. At P_2



Subsidies –

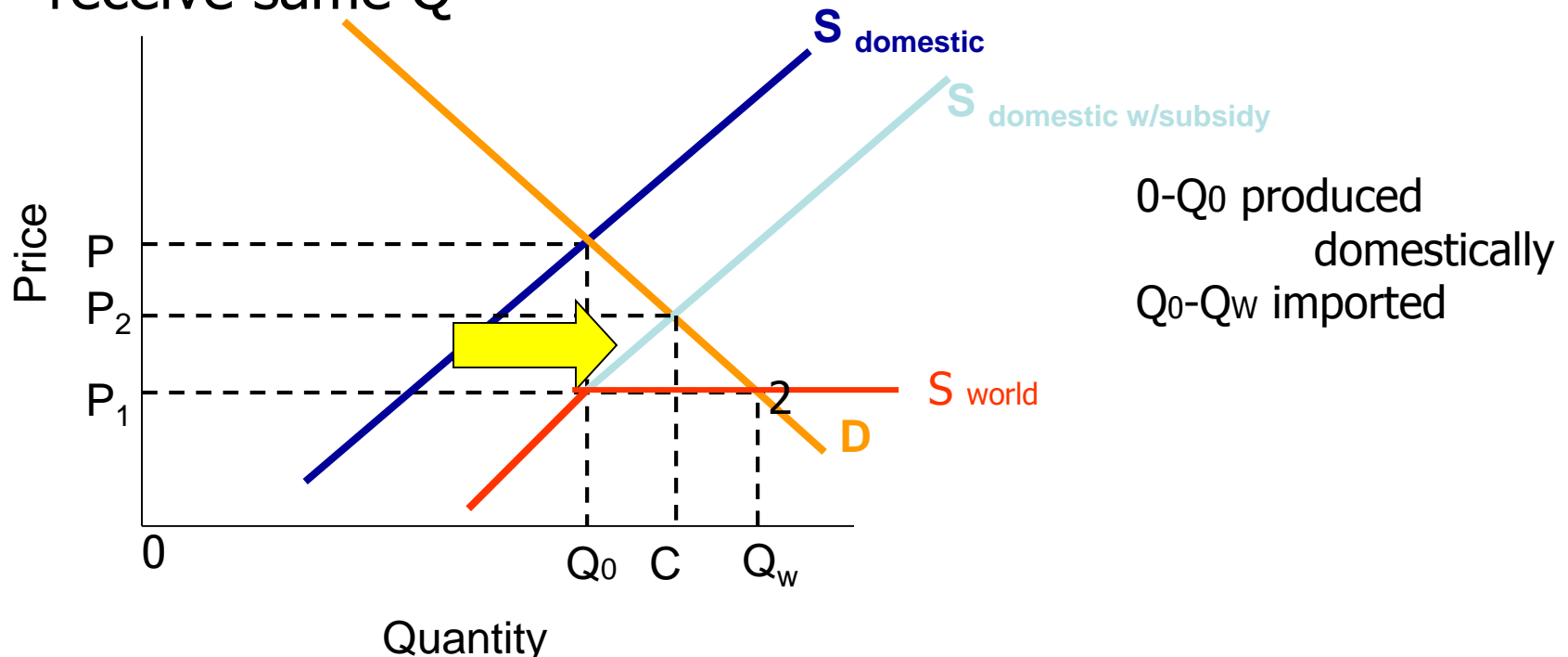
- ✚ applied to domestic goods to make them cheaper and more competitive with imports.





Subsidies – Domestic Impact

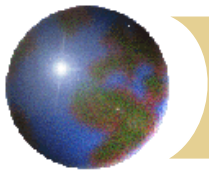
- Domestic producers – this decreases costs for domestic producers so they can compete with imports.
- Consumers – pay same p as with free trade and receive same Q





Alternative Forms of Protection

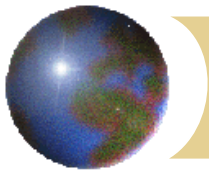
- ✚ Voluntary Export Restraints (VER)
 - ✚ Exporting country agrees to a voluntary quota of exports into a second country
- ✚ Exchange Controls
 - ✚ Government limits amount of foreign currency available to importers, or citizens traveling abroad, or companies investing abroad
- ✚ Import Licensing
 - ✚ Form of rationing where the importer must obtain a license, or permission to import
- ✚ Administrative Barriers
 - ✚ Safety, health or environmental requirements
 - ✚ Other forms of “red-tape” obstacles



Arguments for Protectionism

- ✚ Military self-sufficient
- ✚ Infant Industry
 - ✚ Protect developing industry in LDCs
- ✚ Declining Industries
 - ✚ Allow firms a period of protection
- ✚ Protecting Employment
- ✚ Anti-Dumping
 - ✚ Dumping: product exported at a price below production costs





Arguments Against Protectionism

✚ The reading does an excellent job of presenting this material, what do you think?

✚ HIGHER PRICES

✚ Poor Resource Allocation

